



Third Party Payment Processors Association
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Sent Via Email – 11/1/19

Attn: MSB Model Law
Conference of State Bank Supervisors
1129 20th Street NW, 9th Floor
Washington, D.C. 20036
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RE: Request for Comments: MSB Model Law

Dear CSBS Non-Depository Supervisory Committee:

The Third Party Payment Processors Association (TPPPA) is grateful for the opportunity to provide comment to the Non-Depository Supervisory Committee (the Committee) related to its draft model money services businesses (“MSB”) law. The TPPPA is an industry association formed in 2013 whose members include payment processors and banks that sponsor payments into the various payment systems. The TPPPA has created industry best practices for payment processors and banks through the TPPPA Compliance Management System (CMS). The CMS consists of a control framework that supports both member classifications in creating risk-based, documented compliance management programs for payment processing that are tailored to the unique requirements and responsibilities of the members’ distinct payment processing programs. The CMS is designed to support all forms of payment processing (e.g. ACH, Card, Check) and was created to address the oversight of state and federal regulatory agencies, including the FDIC, OCC, FRB, CFPB, FTC, FinCEN and the CSBS.

The TPPPA and its members appreciate the important role that states play in protecting their consumers, supporting small business, promoting safe and responsible innovation, and upholding fair competition. We also appreciate the efforts of the CSBS to address the concerns of our members and the industry related to the complex web of state laws and licensing requirements. Regulatory complexity has the effect of stifling innovation for responsible companies, while irresponsible companies frequently thrive on the confusion. It also makes it difficult for banks sponsoring companies into the payment systems to be able to adequately identify and manage risk. Regulatory clarity supports efforts like those of the TPPPA to promote industry best practices and self-regulation. Efforts by the CSBS to harmonize and create uniform definitions and exemptions across the 50 states and territories of the United States will benefit both businesses and consumers by providing clear and consistent rules across the entire country. These efforts are particularly important at this time when commerce is more and more frequently occurring over the internet.

Because of the CSBS’s important role with respect to creating uniformity in MSB law in both definition and interpretation, we urge the Committee to create model language that is clear and unambiguous related to the intentions of protecting consumers from harm and loss, while recognizing the inherent protections built into the various payment system rules, and the responsibilities, warranties and

indemnities of sponsoring/originating/depository banks in all payment systems. The inclusion of Agent of Payee and Agent and Service Providers of Banks exemptions are examples of the power and simplicity of leveraging the existing responsibilities of banks who are routinely and rigorously examined for compliance for both consumer protection and BSA/AML laws in addition to being audited for compliance with payment system rules.

In support of our comments on the proposed draft law, we have included the following description of the roles of payment and payroll processors and their banks in the payments ecosystem.

Payment Processors and Their Role in the Payments Ecosystem

Payment processors are technology companies that enable other companies to provide electronic payment processing services to their customers. While there are several large payment processors, payment processors are most commonly small-to-mid-sized businesses that offer these services to other small-to-mid-sized businesses, government entities and nonprofit organizations. Payment processors often take on the credit¹ and technology² requirements for processing payments directly through a sponsoring bank.

Without payment processors, many of these small-to-mid-sized businesses would not qualify for electronic payment processing services and lose the ability to compete with larger companies that have the financial and technological capacity to process payments directly through their own bank. Many payment processors have been processing payments for decades, with long-standing relationships with their partner banks and the small business companies that they serve. They provide a more personal touch in relationship management than the very large payment processors, and generally offer better pricing, which benefits small business and ultimately consumers. Payment processors offer industry expertise and support to small businesses which is not generally available from the large payment processors.

In a typical scenario, a customer (most often a consumer, a business, a donor or an employer) will initiate a payment, or batch of payments online or through a mobile application, to a merchant, another business, an employee, a government agency or nonprofit organization. The payment data is actually transmitted to the payment processor. The primary role of the payment processor is to collect payment data and properly format payment instructions to the requirements of the applicable payment system in order to facilitate straight-through electronic payment processing. The information that the payment processor receives in the form of payment instructions is generally limited to information about the payment. This

¹ Banks require companies that originate payments through them to be in financial good standing (i.e. credit worthy) as the bank is ultimately responsible for the return of funds based upon the warranties it provides under the payment system rules. The bank is debited for any returned payments, such as standard returns (e.g. insufficient funds, stop payments, account closed), and unauthorized returns and/or chargebacks initiated by the person making the payment. Standard returns generally have a two-day return window, but unauthorized returns and chargebacks, particularly from consumer accounts, have extended return timeframes through the payment systems in alignment with Regulation E, Regulation CC and private network rules (e.g. Visa, Master Card, NACHA, ECHHO.) Payment system warranties for these returns are always directly with the sponsoring bank. Warranty claims can be made against the bank well beyond the timeframes allowed through the payment systems. The bank needs to have the ability to be reimbursed for these returns and will seek reimbursement directly from the payment processor rather than from the originator of the payments.

² Each payment system/network, (e.g. Card, ACH, Check) has its own set of rules and technical requirements that must be met in order to facilitate straight-through automatic payments. Each of the payment system has its own exact data set requirements for the formatting of the electronic records and files that contain the payment instructions. There are also multiple data sets for the variety of different types of transactions that flow through the payment networks. Each data set is distinct to align with the payment system rules for different types of payment, (e.g. payments authorized over the telephone, payments authorized over the internet, payments authorized at the point of sale,) because the legal and regulatory requirements (e.g. Regulation E) that are built into the payment system rules require that each payment be properly identified in order to apply the applicable rules. Additionally, payment systems have data security requirements for proper handling and storage of non-public personal information, such as account number and bank routing information.

information is the routing number, account number, type of payment, amount of the payment, and whether the transaction is a debit or a credit. (Note: The payment instructions do not include information that would identify the state of residence of the person receiving the debit or credit.) The payment processor will then forward these payment instructions to the bank that is sponsoring the payments into the payment system³, the bank will then forward the payments to the payment system operator.⁴ The payment instructions, which are associated with the settlement of the funds transfers between banks, are also provided to facilitate the automated posting of accounting entries to the banks' respective customers. Payment processors facilitate the transfer of data. Banks facilitate that transfer of funds.⁵

One of the stated primary policies of the draft model language is to “protect consumers from harm, including all forms of loss,” and the standards that apply to payment processors achieve this policy objective. Each of the payment systems provide protections to consumers that allow consumers to reject unauthorized or improper payments. This is facilitated through the extended return timeframes in ACH, that align with the requirement of Regulation E (which also applies to debit card payments.) The NACHA⁶ Operating Rules even allow the consumer to return payments as unauthorized for incomplete transactions, where the company that the consumer is paying did not receive the funds from the payment processor after settlement. Card holders have the ability to chargeback unauthorized or improper payments. Consumers receiving unauthorized or improper remotely created checks also have extended return timeframes facilitated by Regulation CC and the ECCHO Rules⁷. Each of these provisions rely upon the warranties of the bank that is sponsoring the payments into the various payment systems.

The nature of these consumer protection laws, rules and regulations, allow the consumer to be made whole in a timely manner by the consumer's bank who then relies upon the warranties provided by the sponsoring bank to be reimbursed⁸. The payment systems each have timeframes in which the payments can be returned to the consumer through the network, but generally these warranties extend beyond those timeframes and the consumer's bank can make a warranty claim outside of the payments network against the sponsoring bank. This warranty structure imposes the responsibility on the sponsoring bank and payment processor(s) to conduct proper due diligence on a merchant and to monitor the returns and chargebacks, along with consumer complaints, in order to effectively manage their exposure to credit, compliance and legal risks related to consumer protection. The TPPPA CMS was designed to support

³ In some cases, payment processors will transmit this data directly to the payment system operator, but this can only be done through an agreement with the sponsoring bank and the payment system network. The sponsoring bank assumes all warranties for these payments either way.

⁴ Payment system operators may be the same entity as the payment system network, or they may be different entities. For example, in the ACH Network, NACHA is the governing body for the ACH Network responsible for creating and enforcing the network rules. However, NACHA does not act as a payment system operator. This function is performed by the Federal Reserve Bank and The Clearing House, a private payment system operator.

⁵ The payment system operator contracts directly with banks, rather than payment processors. This is because the payment system operators facilitate settlement of the payments through the Federal Reserve Bank's National Settlement Service (NSS), which in turn facilitates transfer of funds between the sponsoring bank to the bank of the customer making or receiving the payment.

⁶ NACHA is a private membership organization for banks clearing ACH payments and is the governing body responsible for network rulemaking published in the NACHA Operating Rules and Guidelines.

⁷ The Clearing House is a private membership organization for banks clearing electronic checks and is the governing body responsible for network rulemaking published in the ECCHO Rules.

⁸ NACHA Rules § 2.4.1.1 Authorization Warranties and § 2.4.5 General Indemnity for Breach of Warranty

banks and payment processors to create compliance management programs to address these requirements.

Business to Business Activities

The TPPPA strongly disagrees with the decision of the Committee to not extend an exemption from money transmitter licensing requirements to business to business activities. Business arrangements are covered under contract law, including payment agreements. As commerce becomes more and more prominent online, the ability to utilize electronic payment processing supports business efficiencies and competitiveness. Mandating that business-to-business payment arrangements require a money transmitter license will have a detrimental impact to businesses, particularly small business, and force many businesses to revert back to paper payment processing. This not only impacts accuracy, efficiency and security, but can also be a competitive disadvantage. While the efforts of the CSBS to streamline licensing will help ease the burden of multi-state licensing, there still remains the cost of money, time and resources that will have a greater impact on small to mid-sized businesses than their larger counterparts. Adding the additional costs of licensing to a business model ultimately increases prices to consumers.

The ACH Network, for example, provides businesses with the opportunity to transition from paper to electronic payments, maximizing cost-savings, efficiency and security. The ACH Network provides businesses with the ability to send machine readable payment information, known as Electronic Data Exchange (EDI) over the ACH Network. EDI is a data format that is used for machine-to-machine exchanges of data and messages for a range of payment and related processes. EDI contains standard data sets to provide accounting and remittance information such as payment orders and invoices. Examples of business to business payments that benefit from EDI includes insurance companies making payments to medical service providers and stores purchasing inventory from manufacturers. There are also banking conventions which are standard data sets used for specific purposes such as Tax Payments, Third-Party Tax Payments and Child Support Payments. EDI data is most effectively utilized when it accompanies an electronic payment.

Business payments in the ACH Network can also be returned as unauthorized. While the timeframe for returning unauthorized business payments through the network is generally two days, rather than the extended return timeframes afforded consumers, businesses can also utilize the warranties and indemnities provided by the originating bank for unauthorized payments.

Furthermore, all payment processing has a business to business component, as the payment processor and the merchant are both businesses and settlement and fees are covered under business to business contracts. This would undermine the payment processor/agent of payee exemption.

The working group reasoned that business to business activities should require a license because payments between businesses are a crucial underpinning to state economies. The TPPPA would argue that business efficiencies and competition, particularly for small business, are also crucial underpinnings to state economies.

Further Considerations for Payroll

The TPPPA also has concerns related to payroll processors being required to have licenses. The vast majority of payroll processors are small to mid-sized businesses offering vital services to other small businesses that lack the capacity to deliver payroll to their employees. Requiring licensing will have the same effect of decreasing competition with the large payroll processors, as described above under business to business activities.

We believe making a decision that will impact an entire industry based upon a fraud event (MyPayrollHR) that ultimately was a failure of the banks providing massive amounts of credit to an individual that was using businesses to perpetrate a fraud scheme is misguided. Had these banks performed proper due diligence and monitoring of these companies and their activities, this payroll event would not have happened. It also points to a lack of effective examinations of these banks for safe and sound credit and customer due diligence practices.

The TPPPA understands that the Committee will conduct further discussions on this topic and would welcome the opportunity to weigh in fully prior to the Committee making a final decision.

Proposed Agent of the Payee Exemption Language

The TPPPA also has several considerations to share with the Committee related to the proposed language of the Agent of the Payee exemption.

Exemptions – “Agent of payee/payment processors” Markup

This chapter does not apply to: (1) an operator of a payment system to the extent that it provides processing, clearing, or settlement services, between or among persons excluded by this section, in connection with wire transfers, credit card transactions, debit card transactions, stored-value transactions, automated clearing house transfers, or similar funds transfers;

(2) an agent appointed by a payee to collect and process payment as the agent of the payee, provided the agent can demonstrate that: a) there exists a written agreement between the payee and the agent directing the agent to collect and process payments on the payee’s behalf; ~~b) the payee holds the agent out to the public as accepting payments on the payee’s behalf;~~ and c) payment is treated as received by the payee upon receipt by the agent so that there is no risk of loss to the individual initiating the transaction if the agent fails to remit the funds to the payee. [This exemption would not apply to virtual currency and/or marijuana industry processing activities. (This sentence could be added for those states that do not wish to exempt marijuana industry and/or virtual currency processing activities.)]

The TPPPA strongly disagrees with the proposed language of item b). This requirement for exemption is not practical for several reasons described below:

- This is not a current requirement of any of the payment system rules.
- Merchants (payees) take payments in many different forms, in-person, online, by mail, over the phone, point of purchase, etc. and do not provide this information today.
- This added requirement would require a massive adjustment to agreements, authorization forms, web pages, point of sale, etc. all at the merchant level.
- Merchants frequently have more than one payment processor for a variety of reasons such as: redundancy; convenience; service levels (e.g. file deadlines.)
- Merchants frequently offer different types of payments (e.g. ACH, card, check) that most likely require multiple payment processor relationships.
- This added requirement also does not contribute to the stated policy objectives of consumer protection, preventing bad actors, or preserving public confidence in any meaningful way.

An Alternative Payment Processor Exemption Aligning with FinCEN’s Payment Processors Exemption

Under federal law, certain payment processors are not required to register with FinCEN as a Money Services Business (MSB) if they meet all of the following: 1) The entity providing the [payment processing] service must facilitate the purchase of goods or services, or the payment of bills for goods or services (other than money transmission itself); (2) The entity must operate through clearance and settlement systems that admit only BSA-regulated banks; (3) The entity must provide the service pursuant to a formal agreement; and (4) The entity’s agreement must be at a minimum with the seller or creditor that provided the goods or services and receives the funds.”⁹

The TPPPA would suggest the Committee consider adoption of the language of the FinCEN exemption above, rather than the proposed language, to minimize confusion but add the following requirements:

- (5) The entity must maintain a settlement account for payment processing that is separate from all operating accounts;
- (6) payment is treated as received by the payee upon receipt by the agent so that there is no risk of loss to the individual initiating the transaction if the agent fails to remit the funds to the payee.

Limitations of Agent of the Payee Language

The plain language of the agent of the payee exemption, and to some extent the FinCEN exemption, could be interpreted to apply to only debit transactions that are in service of a debt. Some states, such as California explicitly state that payments are in service of a debt. The term payee can be easily misinterpreted causing confusion and disparity between states. As such, Agent of the Payee does not appear to be broad enough to include the wide range of payments processed by payment processors, such as ACH payments which can be either debits or credits. Payment processors provide their services to companies for a wide variety of goods and services that extend beyond payments that are in service of a debt owed for goods or services, as with traditional debit merchant processing.

For example, a vast number of electronic payments are “credit payments.” Credit payments include, but are not limited to payroll, loan proceeds or drawdowns from a line of credit, expense reimbursements, distributions from an escrow account and things of that nature. When processing credit payments, the payor and payee are, in a sense, flipped, and the credit is not necessarily in satisfaction of a debt owed.

Another example is “elective debit” payments. Elective debit payments are not associated with the payment of a debt. Elective debit payments include, but are not limited to, transferring funds to investment accounts, making a donation, a campaign or other type of contribution, paying membership/association dues, signing up for services such as online shopping and things of that nature. Like credit payments, elective debit payments do not necessarily relate to the satisfaction of a debt owed.

The consumer/donor/employee does not bear the risk of loss with respect to credit payments and elective payments when these types of payments are initiated. The primary hallmark of the agent-of-payee exemption is that the consumer does not bear the risk of loss when a payment is effected.¹⁰ Because, similarly, the consumer/donor/employee does not bear the risk of loss with respect to credit and elective debit payments, credit payments and elective debit payments should fall within a payment processor exemption. But with certain laws, like California law, these types of payments may not fall within the exemption because the person making the payment does not fall within the current definition of “payor”

⁹ 31 C.F.R. § 1010.100(ff)(5)(ii)(B).

¹⁰ Cal. Fin. Code § 2010.

and the person receiving the payment does not fall within the current definition of a “payee.”

If the Committee decides to keep the Agent of the Payee exemption the TPPPA recommends including definitions of “payor” and “payee”. Proposed language:

“Payee’ means one who is owed payment of money or other monetary value from the payor for the goods or services. A payee includes a person who receives a payment that is not in service of a debt or a non-profit organization, the intended recipient of a donation, or intended recipient of a credit.” “Payor’ means one who owes payment of money or monetary value to the payee for the goods or services. A payor includes one who elects to make a payment that is not in service of a debt or makes a donation to a nonprofit organization or is issuing a credit.”

Nested Payment Processors and Sub-ISOs

Agent of the Payee language can also be misinterpreted to mean that only the payment processor that has an agreement with the merchant (payee) is eligible for the exemption. Nested payment processors, sometimes referred to as “ISOs” (Independent Sales Organizations) also act as agents of the payee in a payments transaction. Like the companies described above that utilize payment processors for electronic payments, nested payment processors are usually small businesses. They utilize the primary payment processors as a gateway to the payment systems for many of the same reasons that a company processing its own payments would, leveraging the technology and banking relationship of its larger payment processor partners. Considering that the flow of authorizations moves with the initial payment instruction that goes to the nested payment processor, then the primary payment processor, the TPPPA and its members believe that both sets of payment processors should be included within the “agent” definition. Otherwise, the small payment processor (and its customers) may be denied the opportunity to process electronic payments, or the primary payment processors would bear the cost and consequences attributed to licensure, without adding additional risk. Proposed language: We suggest adding the following statement to the exemption: *“There can be more than one ‘agent-of-payee’ in a single payment transaction.”*

A New Approach to a Payment Processor Exemption

TPPPA asks the Committee to consider looking newly at the nature of payment processing today and build the language of the law to be broader and less likely to be misinterpreted or interpreted differently from state to state. This could be accomplished by creating another payment processor exemption in addition to Agent of the Payee or replace the Agent of the Payee language in favor of a broader payment processor exemption that utilizes language that addresses both debit and credit payments and does not imply the payment is in service of a debt.

The NACHA Operating Rules utilize broader definitions that do not get bogged down with terms like “payor” or “payee.” Rather, the NACHA Operating Rules focus on the impact to the account receiving either a debit or credit payment. The account holder (the recipient of the debit or credit to their account) is considered the “Receiver”, and company initiating the payment is considered the “Originator” of the payment. (This terminology is also consistent with wire payments.) An Originator can be a merchant who is selling goods or services, but could also be a company paying employees, a church receiving donations or tithes, a non-profit organization receiving donations or membership dues, escrow companies facilitating contract terms, lenders providing loan proceeds or enabling draw down from a line of credit, a government receiving tax payments or paying public entitlements, and more. Utilizing a broader definition as NACHA does would eliminate the confusion of who the payee of a transaction is and whether the Agent of the Payee exemption would apply.

Thoughts in Closing

Banks, today, typically offer checking accounts without issuing checks to customers because it is beneficial to the banks to avoid processing cash or check payments and it makes the entire payment system more efficient, effective and safe. Payment processors play a vital role in providing alternative methods of payment to both consumers and businesses. Consumers have greater options to acquire goods or services, receive payroll, make donations or contributions, contribute to investments, pay taxes, purchase insurance, etc. The ability to choose to make electronic payments also serves the banked, underbanked and even non-banked consumer. This service is facilitated by payment processors in partnership with their banks. Efforts such as these by the CSBS to harmonize and unify laws related to payment processing allows payment processing to evolve in new and innovating ways that benefit consumers and the economy. We thank you for these efforts.

Please feel free to contact me with any questions. The TPPPA would welcome the opportunity to bring a delegation of its members to meet in person to discuss matters further with the Committee.

Sincerely,

A handwritten signature in cursive script that reads "Marsha Jones".

Marsha Jones, AAP, APRP, CAMS
President
Third-Party Payment Processors Association